Market MUSINGS

January 2022

ATTENTION SHOPPERS: PRICES SLASHED AT THE CAPITALIST SUPERMARKET

Dear Family, Friends, and Fellow Investors,

Before musing on issues of the day, let us take a moment to acknowledge the generous market returns of 2021. It's been a good string of years. Thank you, stock gods.

Musings on issues of the day:

Current fears stoked by market declines include a list of concerns: inflation, Fed tightening, Omicron spike, supply chain kinks, worker shortages, Russia, China, and always politics. Let the musings begin.

The Market Decline: As I write to you, the broad U.S. stock market decline is the 43rd, 10%+ pullback during my career, with the average market decline around 14%. And it's an event we, as lifetime investors, know we must anticipate annually. Ominous news surrounds each drop, without fail, because we always have news concerns. Nonetheless, research conducted at Wharton and Yale shows that the long-term U.S. market returns, including all the declines, have been a net positive 9-10% annual average for the past 10, 20, 50, 100, and 200+ years. Again the entire history of the U.S. broad stock market has been that every decline in the past 200+ years has been temporary, subsequently followed by new record highs.

Fed Tightening: Media pundits have been actively howling for the Fed to tighten its monetary policies ceaselessly for the past 18 months before the Fed's loose policies damage the markets. Now that the Fed is ready to tighten, they are howling daily about how the Fed's tight policies will damage the markets. The outlook is currently speculating on three to five Fed rate increases during 2022, at 0.25% each. Historically, rates do rise during robust economic growth, and eventually, the rising cost of borrowed money will tap the brakes of economic activity. Our experience has been that the tapping tipping-point has been around 4% Fed fund rates, and today Fed Fund rates are 0.08%. Meh, I don't advocate worrying just yet.

Federal Reserve Transitory Pivot: The Federal Reserve Chairman, Jay Powell, shifted policy on inflation in recent months. I can't help thinking about the timing of the Fed's language shift around Thanksgiving. The Chairman faced a contentious White House renomination and Senate reconfirmation a few weeks prior. The Fed chief's "transitory" inflation talk was publicly criticized by the White House and Senate leadership. On cue, the Fed released a public statement officially dropping the term "transitory" and swinging policy to battle inflation just weeks before renomination. He got the nod from the White House and Senate. Hmmm, politically motivated pivot?

Inflation: Consumer Price Index (C.P.I.) rose to 7% from 12 months earlier, the highest figure since 1982. Shocking, but let's drill down and take a look at a few standout components of the Index: Gasoline (+49%), Used Cars and Trucks (+37%), New Cars and Trucks (+12%), Furniture (+14%). Call me skeptical, but none of those seem likely to repeat that performance in the coming year. We believe that in the past 12 months, 7% inflation includes some persistent inflation and some transitory inflation. We can imagine in the coming year meaningful improvement of supply/demand challenges. For example, newly manufactured cars and trucks are awaiting semiconductors. The local auto dealer's lot fills quickly as the chips arrive, ending dealers' pricing above sticker price. With another new model year coming in the fall, we can imagine manufacturer incentives to help dealers move excess production. New vehicles find new homes, used cars become abundant, bidding wars end, and prices decline. The final word on inflation speculation goes to the traders/investors with real money at risk. Markets are pricing 10-Year T.I.P./Treasury Breakeven levels at an average annual inflation rate not of 7%, but instead targeting 2.38% for the next ten years.

China: February 2022 is an active month in China as the Winter Olympics in Beijing overlaps with the Lunar New Year, which is like rolling Thanksgiving, Christmas, Hanukkah, and New Year into one holiday. With China's current food and energy shortages, the demand surge affects supplies and prices globally. Coming months will eliminate some demand tightness. Beyond that, Xi continues to face falling property values damaging national households' net worth, troubled bank debt, a pivot against successful businesses and their wealth leaders, starting with Jack Ma. The demographic mismatch between young men and a shortage of young women, a byproduct of the 'One Child policy' that was at its peak 20 years ago, should be 'coming of age.'

COVID-19: It appears that the Omicron wave has peaked in both Florida and nationally. Data scientists believe it's possible that as the omicron variant wave concludes, it may be the last significant wave of cases for 2022. Let's all hope their data-based probabilities are correct.

Worker Shortages: With 10+ million job openings, U.S. workers have abundant opportunities. Unemployment levels are nearing 70-year lows and may get there soon. These are not symptoms of economic woes but of an economic boom. Business laying people off, a leading indicator of a recession, would be a problem. Too many jobs are not a problem, and too few jobs would lead to unemployment increases and a leading indicator of a recession. Again, not a current issue.

Russia & Ukraine: Russian troops are gathering on the border of Ukraine, and tensions are rising. The issues are tense and heated, and the outcomes and risks are significant to global relations. I don't mean to diminish concerns. Any market decline surrounding rumor or action in Eastern Europe/Slavic area will be considered by your portfolio manager as a shopping opportunity.

Final Musings For Your Consideration:

The U.S. Economy: America is experiencing a robust economic expansion, with G.D.P. jumping +5.7%, the best figures since 1984, and marked by solid demand, jobs aplenty, and unemployment (3.8%) nearing fifty-year lows. U.S. households, businesses, and banks are all stable and flush with cash ($4 trillion money market/deposits earning about 0%), credit remains underutilized, and borrowing rates low. Companies will engage in record stock buybacks and mergers and acquisitions.

T.I.N.A. (There Is No Alternative): Investors have few attractive alternatives for liquid investments other than stocks at this time. U.S. ten-year Treasury yields are currently around 1.85%, and deposits pay nothing. Inflation is expected to be higher than earned interest for the next decade. Thus the outlook for high-quality, interest-earning investors is a negative real return for the coming decade - that's investing in losing real money for ten years. So over the next ten years, the stock market is a likely recipient of excess bank and money fund deposits, maturing bonds, and corporate America is expected to record stock buybacks in 2022 and record strategic mergers and acquisitions.

Attention: Prices Slashed: We believe the problems we face today are similar to what they were around Thanksgiving, and what's changed the most is that share prices have been marked down. We believe this to be a sale in the capitalist supermarket, and our job is to improve portfolios, buying stock names from our wish list, which are now on a perceived sale, and we need to do so before the bargains end. We remain optimistic that reasonable returns will be available before this new year ends. Stay tuned.

It was a pleasure seeing many of you at the November and December Welcome Back cocktail receptions. In January, we had a full house for the Annual Client Meeting at the Ritz-Carlton Beach House. Another Annual Client Meeting is scheduled at the Ritz for mid-February, and for those unable to join us, we will offer group Zoom calls with dates to-be-announced (T.B.A.).

Thank you and best wishes for a healthy, wealthy new year.

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